

Remarks
of
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Council of Economic Advisers
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I am delighted to be here. Thank you for inviting me.

The spirit of entrepreneurship that motivates this conference is close to my own family's history. My four grandparents emigrated from Ukraine to the United States almost a century ago, looking for a better life. Soon after arriving, my grandmother opened a small candy store in Trenton, N.J. She faced all the challenges of keeping a small business going. (As a small boy, I thought my grandmother had had the world's best job – she owned her own candy store.) The small business gene must have carried over to my mother, who some years later ran her own hair-dressing salon in the same storefront my grandmother had used. As the President has said many times, small business is a foundation of American prosperity. This was true in the 1920s when my grandmother opened her store and in the 1950s when my mother opened her salon. It is also true today in our complex and rapidly changing global economy.

As you all know, the recent business climate has been especially challenging. In my remarks today, I will first review the current outlook and discuss the effect that Administration initiatives

have had on our economy. I then want to take a longer-term view and discuss ways in which policy can create a pro-growth economic environment, in which the incomes of all Americans can rise and small businesses, including those owned by minorities, can become big ones.

Soon after I arrived at the White House this spring, I began to think of the economy as being caught in something like a tug of war. It was being pulled in opposite directions by several powerful forces of contraction and by some equally powerful forces of expansion.

On the contraction end of this tug-of-war were the shocks that the U.S. economy had experienced over the preceding three years: the end of the high-tech bubble and the consequent effects on wealth, consumption, and especially investment; the revelation of years of wrongdoing at some corporations; and the impact of the 9/11 attacks and the subsequent uncertainties surrounding the war on terror and the conflict with Iraq. Other contractionary forces came from abroad. Many of our trading partners, notably Japan and much of Europe, were growing slowly, depressing our exports. Given these events, it was remarkable that the U.S. economy was not in worse shape in 2002 and early 2003, but this fact was of little consolation to businesses under pressure, people looking for work, or retirees who had seen their savings depleted by the stock market decline.

Pulling hard on the other end of the rope were the expansionary forces of monetary and fiscal policy—the Federal Reserve’s series of interest rate cuts and the Administration’s tax cut in 2001 and the stimulus package of 2002.

This past spring, it looked like the result of this tug of war was a stand-off—a draw between the forces of contraction and expansion. Growth had resumed after the end of the recession in November 2001, but the pace of growth was far from satisfactory. And of course the labor market remained, and still remains, lagging behind.

Faced with this difficult economic environment, the President pushed hard for the passage of his Jobs and Growth initiative to stimulate the economy. Four months after its passage, the economy is now headed in the right direction. The signs of a strong rebound are now numerous, with positive indications coming from retail sales, vehicles sales, disposable income, and the ISM surveys of manufacturing and non-manufacturing activity. According to most private forecasters, growth should be robust over the next several quarters.

The President's tax packages of the past three years have had a substantial impact on the economy. Simulations of a conventional macroeconomic model show that, without the tax cuts, the level of real GDP would have been about 2 percent lower in the middle of 2003. There are about 8.9 million unemployed people today – far too many – but there would be about 1.5 million more were it not for the President's policies.

The President's policies, however, are not only addressing our current problems. They are also putting the economy on a better foundation for the future by giving businesses greater incentive to invest. Recent tax changes have included lower taxes on dividends and capital gains; expensing for small businesses; temporary bonus depreciation; and elimination of the estate tax. In addition, lower individual tax rates help sole proprietorships, partnerships, and S corporations.

As you know, income from these businesses flows through to their owners' tax returns. All of these initiatives lower firms' cost of capital, encouraging them to invest. Higher investment today means that tomorrow's workers will have more capital to work with. This makes workers more productive so that they earn higher wages.

In addition to increasing the level of capital, the President's tax policies will help the economy use its capital more efficiently. Lower taxes on dividends and capital gains reduce the unequal tax treatment of corporate and non-corporate capital. Moving toward a more level playing field between different types of capital means that productive resources are allocated with a focus on business fundamentals rather than the tax code.

Although the tax changes that have already passed are an important step toward greater economic prosperity, the Administration's job is not done. Earlier this month, the President outlined a six-point plan to maintain the economic recovery. This includes making health care costs more affordable and predictable; reducing the burden of frivolous lawsuits on our economy; ensuring a reliable energy supply; streamlining regulations; and enabling families and businesses to plan for the future with confidence by making the tax cuts permanent.

The last plank of the President's six-point plan is tailor-made for this conference – opening up markets for American products. This is music to an economist's ears. No proposition commands greater consensus among economists than that free trade is win-win, raising living standards both at home and abroad.

Among the media and the general population, the benefits of free trade are often misunderstood. When people talk about the gains from trade, they often focus on the jobs that are created by U.S. exports. But the benefits of trade are much greater than that. In fact, the claim that free trade is good simply because it allows us to export has the story almost exactly backwards.

To see what I mean, ask yourself why you engage in the work that you do. Work does have its intrinsic rewards. Whether you're a painter, a policeman, a professor, or even a political pundit, it's nice to feel that your contributions to society are valued. But it's even nicer to get paid. Working can be fun, but so is eating. Unfortunately, it's hard to consume many goods and services if you don't work a little along the way.

International trade is much the same. The United States can take pride in the goods and services that it sends overseas. As I speak, foreigners are eating food raised by Americans, flying in planes built by Americans, borrowing from banks run by Americans, and watching movies and reading books created by Americans. But the real benefit from providing these goods and services is that American exporters earn foreign currency. This foreign currency can be spent on imports that we consume here at home.

Simply put, free trade is good for the country not just because it allows us to export, but also because it allows us to import. It is imports that add to our consumption and raise our standard of living. Using scarce resources to produce exports is the price we pay so we can afford these imports.

Free trade is not a zero-sum game. Just as we benefit from goods that are produced more cheaply abroad, other countries benefit from goods that are built more cheaply here.

Discussions of international trade are not always framed this way. Both the opponents of trade and its defenders typically focus on jobs. The opponents point to jobs lost here at home at firms that compete with imports. Defenders of free trade point to the jobs created at American exporters.

These discussions often generate more heat than light because both sides are right. Some jobs are lost to foreign imports, and some jobs are created by exports. But both the creation of jobs and the destruction of jobs is part of the process by which countries gain from trade. Free trade encourages each country to specialize in what it does best. This separation of tasks raises economic well-being around the world, just as specialization of individual workers into specific jobs makes an individual firm more productive. As one perceptive editorial writer put it, free trade is good because it allows everyone to trade up to better jobs.

Economists have written about the efficiency gains that come from this type of specialization for over two centuries. But the gains from international trade do not stop there.

By exposing our firms to foreign competition, free trade ensures that American businesses strive to become as efficient as possible. I don't need to tell you that the global economy can be a tough place to earn a living. New producers are constantly challenging industry leaders by supplying

better and cheaper goods and services. Many of these new producers are no doubt sitting in this room today.

The constant pressure that comes from international competition ensures that our own producers do not rest on their laurels, and that they consistently strive to make better products more cheaply.

As an example, consider the effect that foreign competition has had on U.S. automakers over the past several decades. There is no doubt that Toyota and Honda have made life more difficult for executives and workers at Ford and General Motors. But there is also no doubt that American cars are better today because of this foreign competition, and that American consumers are better off as a result.

For all of these reasons, the Administration remains a strong proponent of free trade. In the short run, there can be losers as well as winners from international trade. But it is better to retrain workers who are displaced by foreign imports than to keep workers producing goods that can be bought more cheaply from abroad.

Later today, you will hear more about export opportunities that are open to American firms, both large and small. I would encourage you all to embrace the benefits that can come from selling in other countries.

Research shows that good things happen to firms that export. They tend to grow more quickly than firms that do not. They also open themselves to valuable lessons from their trading partners.

As many of you know, making the decision to export is not easy. Looking for customers abroad, ensuring that exported goods or services meet specific international standards, and working through the relevant financing arrangements can be costly. Fortunately, recent advances like the Internet have made it easier for firms to export, because they can match buyers and sellers over long distances.

Let me thank you for your time and attention, and especially, for your hard work in helping to make the American economy one of the most productive the world has ever known.